MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2017/2018

BIE2034 – INTERMEDIATE MACROECONOMICS
(All sections / Groups)

07 MARCH 2018
2.30 p.m. – 4.30 p.m.
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of **SIX** pages with **TWO** sections only.
   Section A – Twenty (20) Multiple Choice Questions
   Section B – Three (3) Structured Questions

2. Attempt **ALL** questions in both **Sections A and B**. The distribution of the marks for each question is given.

3. Answer **Section A** in the MCQ answer sheet provided and **Section B** in the answer booklet provided.

SECTION A: MULTIPLE CHOICE QUESTIONS (40 MARKS)

1. The fundamental identity of national income accounting implies _____.
   A. Expenditure = Production + Income
   B. Expenditure = Production = Income
   C. Income = Expenditure - Production
   D. Income = Expenditure / Production

2. In a two-good economy, the price of video games is $40 and the price of energy drinks is $2. If the annual output of this economy is 100 video games and 500 drinks, the GDP is _____.
   A. $50,080
   B. $25,200
   C. $5,000
   D. $20,200

3. If the simple Keynesian model, if the initial equilibrium level of income is $300 billion, the MPC is 0.75. What is the new equilibrium level of income if government expenditure increase by 20 billion?
   A. $320 billion
   B. $380 billion
   C. $220 billion
   D. $520 billion

4. The nominal interest rate _____.
   A. makes no allowance for inflation
   B. is a percentage of the amount borrowed
   C. is the rate that most banks advertise
   D. All of the above.

5. The Fisher equation implies that an increase in the nominal rate of interest relative to the real rate of interest indicates that _____.
   A. inflation is expected to rise
   B. inflation is expected to decrease
   C. the real cost of borrowing has increased
   D. the real cost of borrowing has decreased

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6. Suppose an economy has a GDP of $10 trillion, and that its national saving rate is 20%. If investment is 25% of GDP, the value of net exports is _____.
   A. negative $500 billion
   B. $4.5 trillion
   C. negative $250 billion
   D. $2 trillion

7. If the money demand function is given by $M^d = 10 + 0.2Y - 10r$, then a 10-unit increase in the quantity of money will cause the LM schedule to shifts to
   A. the right by 10 units.
   B. the right by 50 units
   C. the left by 40 units.
   D. the left by 50 units.

8. Suppose the world economy is divided into two halves. In Region A, all economies experience a decrease in desired saving, while desired saving is unchanged in Region B. If there is open trade and perfect capital mobility across the two regions, which of the following is true?
   A. Actual investment in Region B has increased.
   B. There is a net capital flow from Region B to Region A.
   C. Actual investment in Region A has increased.
   D. All of the above

9. In an open economy, gross domestic product equals $2,450 billion, consumption expenditure equals $1,390 billion, government expenditure equals $325 billion, investment equals $510 and net capital outflow equals $225 billion. What is national saving?
   A. $225 billion
   B. $510 billion
   C. $735 billion
   D. $1,390 billion

10. In the small closed economy of San Lucretia, the currency is the denar. Statistics for last year show that private saving was 60 billion denars, taxes were 70 billion denars, government purchases of goods and services were 80 billion denars, there were no transfer payments by the government, and GDP was 400 billion denars. What were consumption and investment in San Lucretia?
    A. 270 billion denars for consumtion, 50 billion denars for investment
    B. 260 billion denars for consumtion, 60 billion denars for investment
    C. 250 billion denars for consumption, 70 billion denars for investment
    D. None of the above is correct.

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11. According to the IS equation, a change in which of the following will cause a change in output?
    A. Real interest rate
    B. Autonomous investment
    C. Marginal propensity to consume
    D. All of the above

12. From the equation of exchange, if both nominal income and the quantity of money (M) have tripled, while the price level (P) has increased by 50 percent and velocity (V) remains constant, then real output (Y) _____.
    A. also triples
    B. increases by 50 percent
    C. doubles
    D. decreases by 50 percent

13. Keynesian economist's _____.
    A. observe that prices respond slowly to changes in supply and demand
    B. believe that the classical dichotomy does not hold in the short run
    C. believe that monetary policy affect aggregate output and the real interest rate
    D. all of the above

14. A change in which of the following causes a shift in the IS curve?
    A. autonomous investment
    B. autonomous net exports
    C. taxes
    D. all of the above

15. The IS curve is $Y = 20 - 1.5r$, and the aggregate demand curve is $Y = 15.5 - 0.3\pi$. When the interest rate is 7 percent, the inflation rate is _____ percent.
    A. 14.6
    B. 9.5
    C. 3.6
    D. 20

16. In the new Keynesian model, expected inflation is a function of _____.
    A. expected future output gaps and markup shocks
    B. current and past inflation
    C. unanticipated aggregate demand shocks
    D. expected growth of the money supply

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17. Which of the following is true with regard to the supply of money?
    A. An open market purchase of government securities will increase liquidity
    B. An open market sale of government securities will decrease liquidity
    C. Liquidity and the money supply are directly related
    D. All of the above

18. Suppose you reserve a hotel room in Madrid for $300 per night. When you check out, you are charged only $285 per night. Assuming that the price of the room in euros had not changed, and that the nominal exchange rate had been 0.8 (euros/$) when the reservation was made, the new nominal exchange rate is _____.
    A. 0.84
    B. 0.76
    C. 0.95
    D. 1.05

19. The LM curve slopes upward because
    A. as income rises, savings rise, increasing output.
    B. as interest rates rise, the money supply rises, increasing output.
    C. as interest rates rise, planned investment must fall, increasing output.
    D. as income increases, money demand rises, which increases interest rates.

20. _____ highlights the importance of fiscal policy as a determinant of good macroeconomic performance.
    A. The real business cycle model
    B. The traditional Keynesian model
    C. The new Keynesian model
    D. Rational expectations

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SECTION B: STRUCTURED QUESTIONS (60 MARKS)

QUESTION 1 (20 MARKS)

a) Derive the relationship between savings, domestic investment, and net capital outflow using the national income accounting identity. (5 marks)

b) Assume that following equations describe the money market of an economy
$M^s = 1,000$
$M^d = .2Y - 100r$

   i)   Calculate the LM curve for this economy. (3 marks)

   ii)   Now assume that the money supply rises to 1,200. How much and in what direction has the LM curve shifted? (3 marks)

c) Explain how the following will affect the equilibrium level of interest rates.

   i) An increase in the cost of using Automated seller machine (ATMs) (2 marks)

   ii) The government runs a substantial budget surplus and repurchases bonds from the private sector. (2marks)

   iii). A fall in consumer confidence (2marks)

d) i. What is Laffer curve? (1 mark)

   ii. What do supply-siders assume about the position of the revenue maximising tax rate relative to current tax rates? (2marks)

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QUESTION 2 (20 MARKS)

a) Explain how the Keynesian view differs from the classical view with respect to saving and investment.   (7 marks)

b) Discuss how "animal spirits" relate to planned investment spending and to unplanned investment spending.   (4 marks)

c) Using the IS-LM model, explain how the equilibrium rate of interest and level of output will respond to the following: (6 marks)
   i. Expectations of a future increase in unemployment
   ii. A fall in corporate profits
   iii. A house price boom

d) $Y = 100$, $P = 80$, and $V = 3.2$.
   i) Using the Quantity theory of money what is the value of M?   (1 mark)
   ii) If Y rises to 105, and the inflation rate is 10 percent, what is the new value of M?   (2 marks)

QUESTION 3 (20 MARKS)

a) What insights into the macroeconomic consequences of financial frictions arise from the new Keynesian model?   (7 marks)

b) How does Real Business Cycle theory explain fluctuations in output an employment?
                                                                         (7 marks)

c) i. Discuss the new classical theory explanation for the Great Depression. (3 marks)

   ii. What is the Keynesian critique for this explanation?   (3 marks)

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